

The Institute of Bankers.

BANKING IN CANADA.

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WHETHER the practice of banking in any country be uniform enough to enable us to discover underlying principles, or so varied that we merely describe the conditions as several related or unrelated facts, we always find that there is a history preceding the attempt to systematise banking, which has more or less influenced the process. We can, for instance, at once distinguish two classes of banking: (1) that which has been influenced by a compromise between the necessities of the government, arising from war or extravagance, and the commercial requirements of the nation; and (2) that happier condition where the law-maker and the banker have been mainly concerned to give the people the best instrument in aid of commerce that they could devise. Scotland and Canada seem to be instances of this latter class. But in Canada, as elsewhere, the attempt to systematise has been influenced by public opinion based on past history, which has demanded consideration. In the history of banking, Canada is not, as might be supposed, one of the new countries of the world. Following the systems of barter established by law, the history of currency in the old Canada which preceded Confederation, begins in 1685 with the issue by the French Colony of one of the earliest forms of fiat paper money in the western half of the world. Indeed, this ingenious experiment is supposed to have inspired the British colonists of Massachusetts to venture upon the same kind of money. The general use later on of such paper issues by all the colonial governments was naturally followed by the famous Continental currency of the Revolution. It was because none of this paper money in its later issues was paid in full and much of it was not redeemed in any manner, that the

people of old Canada were so wary and incredulous when, after the establishment of representative government, efforts were unsuccessfully made in 1792, 1807 and 1808 to obtain the authority of Parliament for banks of issue.

In order to pay the expenses of the war, issues of fiat money for which the credit of Great Britain was pledged, were made from 1812 to 1814 through the Army Bill office, and were redeemed during the ensuing four or five years. It was not until after this, in 1817 and 1818, that the first banks were created in Lower Canada, now Quebec. They were at first private corporations, but obtained charters in 1821 to which the Royal assent (then necessary) was given in 1822. In 1817 the Provincial Parliament of Upper Canada (now Ontario) was also asked to incorporate a bank, and consented, the Lieutenant-Governor, however, reserving his signature for the Royal assent, which was given in 1821. There was a dispute between two sections of Upper Canada over this charter, and eventually it took shape as a bank in which the Provincial Government owned about one-fourth of the stock, with the right to name four out of fifteen directors; the only instance, fortunately, of state ownership in our banking history.

Turning to the Maritime Provinces, which became a part of the present Canada in 1867, we find that in Nova Scotia unsuccessful efforts were made in 1801 and 1811 to form banks. In 1812 the Provincial Government brought out an issue of treasury notes, bearing interest and not re-issuable, but this was immediately followed by an issue *not* bearing interest and *re-issuable*. From this time until Confederation (1867) the Province continued to issue treasury notes, sometimes redeemable in gold and sometimes not, having finally in circulation £605,859 (Halifax currency), not a large sum, but, unfortunately, more than the new Dominion Government felt able to redeem in cash. This was the beginning of the present legal tender issues, the least defensible feature in Canadian currency and banking, to which I shall refer hereafter. Early in 1820 Royal assent was given to a charter for a bank in New Brunswick, but, despite the attempts early in the century and doubtless because of the existence of the Government treasury notes, no bank was started in Nova Scotia until 1825. This was a private bank, and remained so until 1872. The first joint stock bank was not created until 1832.

It may safely be said that the three charters granted in Lower Canada, all practically alike, are the substructure on which all subsequent improvements have been built, and that no very radical changes have been at any time necessary. Indeed, there are many provisions in these charters which were subsequently included, almost unchanged, in the general Banking Act. Among the provisions which, although different in detail, are not essen-

tially different in principle from the present Act are the following :—

1. The charter was to continue in force for ten years.
2. The directors were to be British subjects. The qualification in stockholding was quite small, namely, four shares of £50 currency each, or \$800 par value. The directors were not to act as private bankers. They were to be remunerated only by compensation voted by shareholders at an annual meeting.
3. The directors were to appoint officers of the bank and to take surety bonds for faithful performance of duties. They were to declare dividends, when profits were earned, as often as half-yearly. They must not, in paying dividends, encroach upon the capital. They must keep proper stock books. They had the right to inspect all books, correspondence and funds of the bank. They were obliged to submit a clear annual statement of the bank's position to the shareholders at the annual meeting.
4. The bank might receive deposits, deal in bills of exchange, discount notes, buy gold and silver coin and bullion, etc., but might not engage in business other than banking.
5. It could not lend money directly upon real property. It could, however, take such property as additional security for loans already made. It was not permitted to lend money to a foreign country.
6. It could issue notes to circulate as money, but with no limit of amount other than the general limit for all obligations. The limitations at the present time are quite different.
7. The Government might require at any time, for the protection of the public, a statement under oath of the position of the bank.
8. Transfers of shares in the bank were not valid unless registered in the stock-book of the bank, and the bank had a prior lien on the stock for ordinary debts due by the holder.

The following regulations, on the other hand, are different in principle from the general Act now in force :—

1. The total liabilities were not to exceed three times the capital stock actually paid in, and directors were personally liable if they permitted such excess. Any director might save himself from liability by publicly protesting within eight days after the transactions causing the excess took place.
2. The shareholders were exempt from liability except that of payment for the stock for which they had subscribed, with a penalty of five per cent. for non-payment of instalments at maturity.

3. The voting power of shareholders was not, as now, in exact proportion to the shares held, but the number of votes diminished by a scale as the holdings increased; so that, while one share gave one vote, ten shares gave only five, and thirty shares only ten. No holding gave more than twenty votes.

The banks soon opened branches and agencies, and imperfect in detail as it was at this time, the present system of banking began its course. From the first the banks exercised, under the scrutiny of Government and Press, the great franchise of note issues unsecured by any special pledge; they possessed the identity given by separate charters and clearly distinguishing titles; they opened branches and assumed the widest functions of banking without discussing the precise powers accorded by these charters. Possessing capital quite as large relatively to the size of the community as they have now, they assumed without hesitation a national position as clearing-houses for the exchange of the country's products.

Of the banks thus created—three in Lower Canada, one in Upper Canada, two in Nova Scotia and one in New Brunswick—all but one in Quebec became leading institutions, and all are either in high standing to-day or have honourably amalgamated with existing banks, except the institution in Upper Canada unhappily joined to the State and said to have been swayed by politics. It failed in 1866, after a career of nearly half a century, the most serious calamity in the history of banking in Canada up to the time of Confederation.

When we look at the map, the extent of country to be served by these six banks seems very great, but when we consider the population and the nature of the commerce, it is difficult to understand how they managed to survive. A scanty population, settled here and there at seaside ports and on the shores of rivers and lakes, without means of communication worthy of the name, without manufactures, with agriculture so little advanced that the products of the chase and the forest were more important as exports than the results of farming, there was but little basis for sound banking, and its development lacked interest until many years after this period. In Lower Canada the volume of business considerably more than doubled, apparently, between 1820 and 1830, but in the latter year the figures, exclusive of that bank in Lower Canada which did not survive and which was almost liquidated, were very trifling. The liabilities were as follows:—Capital, £304,000; notes in circulation, £217,000; deposits, £163,000; while other items made the aggregate a little more than £700,000 currency. The assets to represent this were, loans £602,000, and cash £103,000. In the same year a return of one bank in Upper Canada shows liabilities as follows:—Capital,

£77,000; notes in circulation, £156,000; deposits and other debts due, £38,000; making an aggregate of less than £275,000 currency. This was represented by loans of £214,000; cash, £23,000, and other assets of about £30,000.

It will be well to indicate as briefly as possible the new features which have survived from this period and which were subsequently added to those in the three original charters in Lower Canada.

1. In Upper Canada the principle was established that a bank could buy real estate only for its own use, whereas in the Lower Canada charters there was merely a provision as to the annual value of real estate held by a bank.

2. Inability to pay notes in specie involved stoppage of business, etc. The reason for this may be found in contemporaneous history in the United States.

3. In Nova Scotia the double liability of shareholders was introduced, which did not exist in Upper and Lower Canada. This was a liability after exhausting the ordinary assets in the event of failure, to pay assessments sufficient to meet all liabilities, provided such calls in the aggregate did not exceed the original amount of capital paid in.

4. In New Brunswick, as the result of recommendations of the Committee for Trade of His Majesty's Privy Council for 1830 and 1833, the following features were adopted:—

(a) No bank-notes to be issued until one-half of the authorized capital stock was paid in. Public commissioners to count the cash in the vaults and ascertain that it was actual capital paid in.

(b) Loans on pledge of the bank's own stock forbidden.

Similar provisions to both of these were about this time found necessary in the United States.

Previous to 1830, while a charter with express power to issue circulating notes was most desirable, there was no law forbidding private individuals to issue notes. In Lower Canada, in that year, an Act was passed partially prohibiting such private issues. But during the disorganized state of trade and finance at the time of the Rebellion in 1837, notwithstanding the penalties, there was a flood of paper issues by private banks and merchants, largely for sums less than a dollar, and it was found necessary, temporarily, to make these issues legal. Until the Rebellion it was still possible in Upper Canada for private banks to issue notes, and during the period of trade expansion which preceded the general financial collapse in North America in 1837, several ventures with titles sounding like incorporated bodies, but really

private firms, came into existence. As a result, Upper Canada also passed legislation making such issues illegal.

During the ten years preceding the union of Lower and Upper Canada in 1841, ambitious schemes of public improvement had been undertaken, there had been much speculation in land, and trading generally exceeded our financial capacity. In the United States the same conditions had brought about most unsound ideas regarding banks. Our people, especially in Upper Canada, were much influenced by these novel views on banking, and about twenty-five bills on the subject of banking and currency were introduced, but, as such measures had then to be referred to the Colonial Office for Royal allowance, none of these schemes came into effect, and, much as we enjoy the benefits of home rule to-day, we have to thank the Colonial Office after this lapse of time for its attitude, although there was much criticism of that department at the moment.

Thus far no joint-stock bank had failed, and, if we except the suspension of specie payments at the moment of the Rebellion in Canada and of the great panic in the same year in New York, the bankers had never failed to pay their notes on demand. The two Governments had not resorted to the issue of paper money, and the main principles of our banking had been step by step established.

The first Governor-General of the new Province was Lord Sydenham, who held the same currency views as Lord Overstone, and it was at this period that the controversies were being carried on which resulted in England in the Bank Act of 1844. Lord Sydenham favoured for Canada a provincial bank of issue, and he outlined a scheme under which he proposed to cancel the right of issue by the chartered banks, remunerating them therefor; and by giving it to this institution, which was not to do a general banking business, he hoped to make a large profit for the Government. He proposed a gold reserve of one-fourth of the issue, with Government bonds for the balance, and a fixed maximum for the issue, and he claimed that such a system would ensure ready convertibility. But the Canadian people were intelligent enough to see the defects of such a system, and, apart from other faults, the lack of elasticity alone condemned it. It was opposed, of course, by the banks, but also, on many grounds, by the general public, and did not become law. The Legislature, however, took advantage of the opportunity to impose a tax on bank-notes of one per cent. per annum on the average amount in circulation.

The union of the two Provinces emphasized the importance of uniformity in banking, and a committee on banking and currency, after considering the recommendations of the Home Government contained in the dispatch of Lord Russell of May 4th, 1840, already referred to, reported in favour of certain prin-

ciples, the only new and important point of which was the restriction of the note issues to an amount not greater than the paid-up capital.

I have now sketched briefly the principles which eventually formed the foundation of the banking legislation at the time of Confederation in 1867. There were, however, two aberrations from sound principles at a later time to which I must refer, one of short duration, the other still existing, but, while bad in principle, not mischievous at the moment.

The first was the so-called "Free Banking Act" of 1850. We were then, as now, carrying on banking through a few institutions, with large capital, with branches and a bank-note issue not specially secured. In the near-by State of New York the opposite policy of banks with small capital, no branches, and a specially secured note circulation was on trial, the special security being canal and railway bonds, municipal securities, etc. We had come through trying times without failure, but our pace was too slow for the public. And so "An Act to Establish Freedom of Banking in this Province, etc.," intended to create small banks without branches and with bank-notes based upon the securities of the Province, was passed. The history of this folly may be read elsewhere,* and it seems sufficient to say that within ten years the system had practically come to an end.

The other aberration from the path of virtue was connected with the finances of the Government. We have noticed that in Nova Scotia the Government had resorted to the issue of treasury notes as early as 1812, but the other parts of British North America had not been embarrassed by such currency. In old Canada, in 1860, the Minister of Finance had proposed the establishment of a provincial bank of issue, but this was not acceptable to the Legislature. In 1866, just preceding Confederation, however, power was obtained to issue notes which should be a legal tender and be payable in specie at Montreal and Toronto. When I tell you that the debt to the Government's bankers which caused this expedient to be resorted to was only about \$5,000,000, and that the maximum of these legal tender notes was fixed at \$8,000,000, while the whole note issue of the banks was only about \$10,000,000, you will realize how small the financial affairs of Canada were at the moment of that Confederation which has resulted in the Canada of to-day. An attempt was also made to induce the banks to surrender the powers of issue on receiving compensation, but this failed.†

In the history referred to, the development of our system of banking, both before and after Confederation, is dealt with, and

* "History of Banking in Canada :" Walker. 1896 and 1909. Page 41.

† Further details of this period may be found in Chap. III, p. 45 *et seq.*, of the same history.

I shall ask anyone interested in the subject to allow me to send him a copy of this book. I have sought now, however, merely to say enough to indicate how this system came into being, and, so far as it is necessary to refer to further changes in it, I shall do so without reference to chronology, directing any who are interested to Chapter IV, where the first attempts at legislation by the new Dominion Government are dealt with and where an abstract of the Act of 1891 is given.

Note Issues.

Doubtless the sections in our Bank Act of most general interest are those dealing with our power to issue circulating notes. Apart from various qualifications, the power is expressed as follows:—"The bank may issue and re-issue notes payable to 'bearer on demand and intended for circulation.'" The first qualification is that the notes must not be smaller than five dollars, and all notes for other amounts must be for multiples of five dollars. Previous to and for a few years after Confederation, bankers had the power to issue notes of such denominations as one and two dollars, but the issue of these change-making notes was regarded by the Government as an opportunity for the circulation of their legal-tender issues, in which shape all change-making currency, except subsidiary coinage, exists in Canada to-day. The second qualification bears upon the maximum to be issued by any one bank. In the early banking of a new country deposits are scarce and the power of note issue is the main reason for organizing a bank. The charters of 1821 contained no restriction other than that the total of *all* liabilities to the public must not exceed three times the actual capital, but all Acts since Confederation until 1908 provide that the circulation shall not exceed the unimpaired paid-up capital, enormous fines being imposed for any breach of the Act. There is a further limitation in the case of one bank still working under a Royal charter. In July, 1908, a short amending Act (chap. 7, Statutes of 1908) was passed, authorizing any bank, from 1st October to 31st January in the following year, that is to say, during the usual season of moving the crops, to issue circulating notes in excess of its paid-up capital to the extent of 15 per cent. of its combined unimpaired paid-up capital and rest or reserve fund, as shown by the statutory monthly return made to the Government for the previous month. Upon such notes interest at whatever rate, not exceeding five per cent. per annum, is fixed for the purpose by the Governor-in-Council, is to be paid to the Government as part of the general revenues of Canada. A return showing the amount of the excess notes in circulation must be sent monthly to the Minister of Finance.

Since 1880 note issues have been a prior lien upon the estate of a bank, prior even to a debt due to the Crown. This legislation was prompted by the failure of a small bank in 1879, which did not pay its notes in full. The bankers had urged such legislation in 1869, and, if they had succeeded in obtaining it then, we should be able to say to-day that, without further security than this prior lien on all assets, note issues had always been paid in full, no matter how bad the failure of the issuing bank.

At the revision of the Act in 1890 it was recognized that there were still two minor though serious defects in the system. It was frequently alleged by those who admired the National Bank Act of the United States, that while the currency created by it might not be elastic, the notes could not for any reason fail to be paid in full, or to circulate without discount throughout the entire area of the United States, while in Canada no similar boast could be made. The area of Canada is enormous relatively to population, and the notes of banks in one Province certainly passed at a discount in some of the others, a recurrence in a less aggravated form of a defect in the old State-bank issues of the United States. And, while it might be confidently asserted that all bank issues secured by being a first lien on the estate of the banks would eventually be paid in full, it was nevertheless true that, because of doubt and delay, the notes of a suspended bank might fall to a discount for the time being. To meet these two defects, the bankers at this time proposed the following new features, which were adopted by the Government:—

1. To avoid discount at the moment of suspension of a bank, either because of delay in the payment of the note issue by the liquidator or of doubt as to ultimate payment, each bank is obliged to keep in the hands of the Government a deposit equal to five per cent. on its average circulation, the average being taken from the maximum circulation of each bank in each month of the year. This is called the Bank Circulation Redemption Fund, and should any liquidator fail to redeem the notes of a failed bank, recourse may be had to the entire fund if necessary. As a matter of fact, liquidators are almost invariably able to redeem the note issues as they are presented, but, in order that all solvent banks may accept without loss the notes of an insolvent bank, these notes bear five per cent. interest from the date of suspension to the date of the liquidator's announcement that he is ready to redeem.

2. To avoid discount for geographical reasons, each bank is obliged to arrange for the redemption of its notes in certain named commercial centres throughout the Dominion.

Both of these reforms were suggested by the speaker, but, like many other features in our Act, they were prompted by the

experience of the United States in the period preceding their present banking system. That our bank-notes are abundantly secured, so far as the public is concerned, seems evident from the fact that a note circulation at 31st December, 1910, of \$87,694,840, was in effect secured by a prior lien on total assets of \$1,229,790,859, to which must be added the double liability of the shareholders on the capital stock of the banks, making a total of \$1,330,573,425. That the banks are not likely ever to lose a dollar by the system of guaranteeing each other's notes seems quite clear. Daily redemption and other features in the Act make it difficult to create a forced circulation, and, although we have had several fraudulent bank failures, there has never been a case where the assets on which we had the first claim did not easily protect us.

In Canada gold is not used as a currency, but as a bank reserve. Of the legal tenders issued by the Government, as will be seen hereafter, over seven-ninths are held as bank reserves, while the remainder are the change-making notes—that is, those smaller than five dollars. So that the business of the country, apart from cheques and other credit instruments, is done with bank-notes and small legal tenders. As we are a country with wide fluctuations in the volume of business during the year, owing to crop moving and to the great variation in the seasons, we require great flexibility in the currency. The following figures illustrate the range of the bank-note circulation in each year:—

		Lowest.	Highest.	Percentage of Difference.
1906	...	\$60,986,610	\$83,718,630	37·3
1907	...	68,219,717	84,452,899	23·8
1908	...	66,712,899	83,036,762	24·5
1909	...	65,819,067	89,633,549	36·2
1910	...	73,378,676	95,992,866	30·8

Thus far in our history a sufficient quantity of bank-note circulation for our maximum requirements has been forthcoming. Daily redemption prevents an excess, and the profit from the circulation causes the increase in the share capital necessary as the basis for more circulation. It is not clear that this relation between share capital and the currency requirements will go on automatically. If it does not, there will doubtless be at the bottom of our currency a quantity of notes, issued either by the Government or by the banks, which will be secured by a deposit of gold, and the ordinary bank-notes with their daily redemption will provide the necessary flexibility.

The following figures of our total bank-note issues over a series of years afford an illustration of the growth of Canada:—

Date.	Amount.
Dec. 31st, 1867	... ... ... \$8,851,451
Dec. 31st, 1870	... ... ... 18,526,212
Dec. 31st, 1880	... ... ... 27,328,358
Dec. 31st, 1890	... ... ... 35,006,274
Dec. 31st, 1900	... ... ... 50,758,246
Dec. 31st, 1910	... ... ... 87,694,840

It may be desirable at this point to explain the present state of the legal-tender issues of the Dominion Government, and why, although partly wrong in principle, they are no longer a menace to Canadian finance. At the moment of Confederation in 1868, as I have said, the issue of old Canada was limited to \$8,000,000, and this was assumed by the Dominion Government. A few years later, in connection with the first general Bank Act of the Dominion, the legal-tender issues were settled on the following basis:—

1. The maximum, covered partly by securities and partly by specie, was fixed at \$9,000,000.
2. This amount was to be secured to the extent of about 75 to 80 per cent. by ordinary issues of the Dominion Government and 20 to 25 per cent. by specie and debentures of the Dominion Government guaranteed by the Imperial Government, the specie not to be less than 15 per cent.
3. Issues above \$9,000,000 were to be covered entirely by specie.
4. The right of the chartered banks to issue notes under \$4 was cancelled.
5. Later on this was amended to include everything under \$5, with the requirement that all larger issues by chartered banks must be multiples of \$5.
6. Of any cash reserves held by the banks 40 per cent. must be held in legal-tender notes.

From time to time the limit of \$9,000,000 under which notes were secured partly by bonds of the Dominion Government and partly by gold was increased, eventually reaching \$30,000,000, at which figure it now stands.

The growth of the country has been such that the change-making notes (notes under \$5), which could hardly be presented for redemption, have absorbed that part of the issue which is not entirely covered by gold, and the larger legal-tenders used mainly

for settlements between the banks are now entirely covered by gold.

At 31st March, 1911, the total issue of legal tenders was \$89,994,000, of which a little over \$18,000,000 consisted of change-making notes. The specie and bullion held by the Receiver-General amounted to \$74,000,000, while the large legal-tenders above referred to amounted to somewhat less than \$72,000,000. From this it will be seen that we can safely consider the legal-tender notes held by the banks as the precise equivalent of gold, and it is also evident that the condition made many years ago, that the banks must hold a part of their cash reserves in legal-tenders, is no longer necessary. Of the \$72,000,000 referred to, over \$65,000,000 consists of notes negotiable only between banks, and these are practically not different from mere Government certificates for coin in possession of the treasury.

The Branch System.

Although the number of establishments was very few, branch banking began soon after the first banks were created in 1817. For sixty or seventy years few banks had more than twenty-five or thirty offices, and I notice that in writing in 1897 I have mentioned the leading banks as having forty to fifty branches. Since then the development of Canada, and especially of the West, has greatly changed conditions. At March 31st, 1911, the chartered banks of Canada had 2,482 branches, 2,420 of which are in Canada. The two largest banks have at the present time about 236 and 153 branches respectively.

In a recent work,* in a comparison as to the banking service to the public in Canadian and United States cities, it is stated that in 1909 there were 115 branch banks in Toronto, 83 in Montreal, 40 in Winnipeg and 35 in Vancouver. The comparison showed that in Canadian cities there is one bank to each 3,100 people, while in United States cities there is one to each 9,700 people. If we turn to the towns, we shall find that Canada is still better served than the United States, but I think we cannot resist the conclusion that the opening of branches is somewhat overdone. Competition is very great, but the belief in the rapid growth of the Western Provinces is greater, and a railway has only to declare that a certain spot will be a divisional point when a bank seizes the opportunity along with the first shopkeepers. Such offices, of course, do not pay for some time, but a carefully administered bank in Canada should have a very definite policy as to how much of its present profits it will spend for future development. Apart from the fact that we are deeply interested

* "A Rational Banking System :" Eckardt, 1911.

in the development of the country, we possess a valuable franchise, and are expected, in return, to render an adequate banking service to the people, a fact of which we are frequently reminded by the Press.

In the United States the tendency has been to construe the Bank Act very strictly, and to argue that a bank may do only what is expressly permitted. In Canada our view is rather that we may do anything natural to banking which is not forbidden. We did not wait for authority to establish branches either at home or abroad, although the authority is now in the Bank Act. It became desirable about half a century ago for the leading banks to have agencies in New York, and those working under Royal charters have always had offices in London. From this we have slowly expanded until there are now sixty-two offices outside of Canada, as follows: In London, 5; in Paris, 1; in New York, 6; in Chicago, 2; in the City of Mexico, 2; in San Francisco, 2; one in each of the following places in the United States—Portland, Ore., Seattle, Spokane and Boston; in Newfoundland, 11 branches, administered by three banks; in the British West Indies, 12 branches of two banks; and in Cuba and Porto Rico, 17 branches of two banks. The most striking feature is, of course, not the number of branches belonging to any one bank, because, in Great Britain our figures would look quite moderate, but the great area over which these branches are spread and the variety in the circumstances surrounding the banking business at the important points. At one moment we may be considering the conditions of a particular manufacturing industry, as you would in Great Britain; at the next those of one of our five or six widely separated timber areas, each having its own particular characteristics; the fishing interests of the Atlantic or of the Pacific; placer gold mining in the Yukon, copper smelting in British Columbia, silver mining at Cobalt, or the prospects of the new Porcupine country; the great agricultural, pastoral, dairying and fruit industries; or immigration and settlement and their effect upon town and railway building. Indeed, there are few things connected with the life of Canada that the banker can afford to leave unstudied, and it naturally follows that a bank with an army of trained observers and a well-organized system for the intercommunication of information other than the facts which must appear in bank returns and ordinary correspondence, is likely to have an advantage over those less well informed.

Supervision of Loans and Credits.

Discussion of the branch system leads naturally to the consideration of banking on the credit side. Apart from transactions in New York, or at other points, where that portion of our

reserves which may safely be placed in call or short loans on securities is carried, our business is more akin to the banking of your ordinary cities, towns and villages than to that of London. There are practically no acceptances by other banks or by wealthy merchants, against shipment of merchandise to Canada, offered for discount. In the main it is a case of establishing a credit for the working of a particular business. I do not know what may be the opinion of outsiders regarding the carefulness or otherwise with which the lending operations of Canadian banks are carried on. It is a time of great expansion and it might be natural to suppose that the requirements of customers would be vaguely considered and the relations between banker and customer ill-defined and sometimes beyond the control of the banker. Doubtless there is a considerable percentage of bad banking in Canada, as in other new countries, but I doubt whether banks in any country are as a rule more explicit in the establishment of credits or do so upon more complete information. Let me explain the system of one bank which has been successfully carried out over a series of years. The borrower is expected to have only one banker, or, if the account is very large and there are two or more bankers, there is a clear agreement as to their respective shares of the bank advances. A bank credit is never established for more than one year, and expires on a particular day. The manager in charge of the account is expected to arrange for its renewal before the date of expiry. If this is not done, the account falls automatically into the irregular class and is under the eye of the superintendent's department until the credit is re-established. A new credit or a renewal of a credit will not be considered without the balance-sheet for the year being submitted, together with as full a statement of profit and loss as is obtainable. I am speaking of credits involving direct advances not covered by securities or by bills of other parties for merchandise sold. When the practice of demanding a balance-sheet from every customer who desired direct loans was put into operation, it was said that it would not succeed. But it has been found that, no matter how wealthy the customer may be, he can be induced to give his full confidence to the banker from whom he is, by his application for a credit, asking practically the same thing. In lending the entire requirements of a timber business, for instance, where a large expenditure in the forest precedes extensive milling operations, sums are advanced, sometimes with no other security than the mere obligation of the customer, which would sound large even to an English banker. The basis for the credit may be mainly the experience of the bank over a series of years, during which every payment out of the business and all receipts for merchandise sold pass through the bank account.

Each year the balance-sheet is presented, and many of its features can be roughly checked by the bank account itself. The branch manager is expected to re-value the items in the balance-sheet, and to analyse it so as to separate the liquid from the fixed assets. If the liquid capital—that is, the surplus of liquid assets over the floating debts—is not sufficient to warrant the belief that once a year the loans will be paid in full, the credit requires at least unusual justification. There are, of course, some trades in which payment of advances once a year would not be wise or natural, but we have been most agreeably surprised at the extent to which, in the last five or ten years, we have succeeded in establishing this as a most important factor in credits. We are, fortunately, forbidden from lending on real property, although it may be taken as security for an existing debt, and long experience has taught the Canadian banker to beware of advances which rest even partially upon the plant or buildings or any of the fixed assets of the borrower. In other countries such banking may be both safe and wise, but our policy is to lend by established credits only the money necessary to produce and carry the merchandise to market. Now, if a customer deals with only one bank, pays for all materials and labour in cash, makes all payments by cheques on his bank, exhibits once a year his balance-sheet and profits, and at the same time discusses at length the various features of his business for the purpose of having his credit re-established, it is not difficult to lend him very large sums with safety. In addition to the analysis of the balance-sheet, comparisons are made with several previous years, and, as all correspondence is conducted on special forms, with only one subject on each form, and everything is typewritten—the carbon copies of one side of the correspondence being filed with the originals of the other side—the banker can, in a moment, have before him in the correspondence and the analysed balance-sheet, practically all that he needs to know. All except the quite small credits are discussed with the board of directors, and the system makes it possible to deal with a large number of credits at each sitting.

Bank failures in Canada show clearly that there is plenty of careless and unwarrantable banking, but, while I have referred to the system of only one particular bank, I believe that, as a rule, the Canadian banker has a very clear notion of what he regards as good or bad banking, and that his relations with his customer are marked by a sensible blending of desire, on the one part, to enable his customer to take advantage of the rapid growth of Canada, and, on the other, to guard the interest of his bank.

The growth of the loans of the Canadian Banks is shown by the following figures:—

Dec., 1867	...	...	...	...	\$55,469,521
Dec., 1870	...	...	...	...	78,095,144
Dec., 1880	...	...	...	...	125,555,284
Dec., 1890	...	...	...	...	202,518,727
Dec., 1900	...	...	...	...	362,004,795
Dec., 1910	...	...	...	...	880,857,520

Deposits.

Consideration of the borrower and of his rapidly expanding wants raises the question as to whether these wants have been supplied. It is, I presume, desirable in every country so to distribute loanable capital that every borrower with adequate security may be reached by some lender, and the Canadian banks with their branches are called upon to perform this service for the business part of the community. They can make loans only out of capital, bank-note issues and deposits, and they naturally bend all their energies therefore towards securing deposits. In this respect they are not different from the banks of other countries, except that each bank office has a savings-bank department. There are only two savings banks of the ordinary type in Canada, one at Montreal and one at Quebec, and they were established many years ago. The Dominion Government competes with the banks for deposits of this class through its Post Office and Government Savings Banks, and some of the companies established for lending by mortgage on real estate also take deposits in Canada, although their deposits are largely obtained in Great Britain.

In the main, however, the Canadian bank, not in London or New York, but wherever else it may be, gathers deposits diligently. It does not profess—although I fear there are exceptions—to pay interest on the current accounts of its customers, but in the savings-bank department it opens interest-bearing accounts practically for any sum, no matter how small or how large. As branches are to be found almost everywhere, as practically all currency except change-making notes is issued by the banks and no gold is abrading its edges in people's pockets, as even trifling payments are made by cheque, and as we have machinery for using both small and large, interest-bearing and non-interest-bearing, deposits, we have managed thus far to meet the requirements of the country so far as commercial loans are concerned. But for the fact that the capital required for loans on real estate and for the purchase of Canadian securities generally, is pro-

vided in Great Britain, and in other European countries, our ability to meet the borrowing wants of the country would be much less adequate.

The amount of capital invested by Canadians in our own securities is very large indeed compared with five or ten years ago, and the drain on bank deposits because of this is persistent, but fortunately most of our large issues of securities are made abroad, and therefore Canadian deposits continue to increase in the aggregate.

The following figures illustrate the growth of banking in the matter of deposits.

	Post Office.	Government Savings Bank.	Special Savings Banks.	Loan Societies.	Chartered Banks.	Totals.
1868	\$ 204,589	\$ 1,483,219	\$ 3,369,799	\$ 673,789	\$ 31,752,776	\$ 37,484,172
1870	1,588,849	1,822,570	5,369,103	1,485,014	50,767,098	61,032,634
1880	3,945,669	7,107,287	6,681,025	11,713,633	84,818,802	114,266,416
1890	21,990,653	19,021,812	10,908,987	17,893,567	136,187,512	206,002,531
1900	37,507,456	15,642,267	17,425,472	19,959,462	285,186,095	375,720,752
1910	42,848,025	14,563,224	32,524,249	*22,933,578	928,699,193	1,041,568,269

* As on 30th June, 1908.

Reserves.

In view of the great expansion of credit in Canada, the matter of our available reserves is gravely important, and we are now large enough to be also keenly interested in the financial conditions of the rest of the world, especially of London and New York. That our reserves are in much better shape than was the case ten or fifteen years ago may, I think, be safely said, but in order to form an opinion, some peculiarities in our situation need to be understood.

The mere statement of the reserve in cash held by a particular bank, or the average held by the banks of the entire country, conveys little idea as to whether prudence is observed or not. In Canada, the average, for many years, of actual cash held in gold and legal tenders as against all liabilities to the public, has been about ten per cent. But, owing to the system of bank-note issues, very little of this is required for daily use, the tills of bank offices being filled with the bank's own notes, which do not appear in its statements as cash because they are not in circulation. Practically, the business across the counter, when not transacted with other paper instruments, is done by means of this till money; the settlements of balances with other banks are made in legal tenders, or by drafts on the chief commercial centres; while the

main reserve may be, in the case of small banks, represented by loans at call or short date on stocks and bonds and by balances in the hands of correspondents at Montreal, New York and London. In addition to such sources of strength, the more important banks have agencies in the United States and England, and the bulk of the capital employed there can be made available without any delay, while practically all can be liquidated within a few months at most.

Gold is not used as currency in Canada, and as we have to pay our foreign debts mainly in New York and London, our strength at these points in addition to actual cash is the practical test of our liquid position.

PERCENTAGES OF QUICK ASSETS TO LIABILITIES TO PUBLIC,
31ST DEC., 1910.

Specie and Legal Tenders	... ... ...	\$109,418,939	10·56 %
Do., and including Cheques and Notes of other Banks, Balances due from Agents and Call Loans out of Canada	... ...	286,484,202	27·65 %
Do., and including Investments and Call Loans in Canada	... ... ...	447,770,796	43·22 %

Bank Failures.

From time to time bank failures take place in Canada, accompanied by evidence of reckless bad management and sometimes of great dishonesty. In every time of unusual inflation several new banks are created. As a charter can be obtained by any set of individuals upon compliance with certain express provisions in the Bank Act, men with more energy as promoters than skill in administering a bank, often appear in the banking world with the necessary permission to issue notes and to do a banking business. In each case a deposit of \$250,000 in cash must be made with the Finance Minister, accompanied by a declaration under oath that this represents actual payments by shareholders on account of shares subscribed and that subscriptions have been obtained to the extent of \$500,000. When the permission to do business has been granted by the Finance Minister the cash deposit of \$250,000 is returned to the bank. In a recent failure it transpired that the \$250,000 had been in part borrowed, and that the declaration made as to actual shares being subscribed to the required amount was false. Now, we may as well admit that in a democratic country like Canada we can never expect to prevent the creation of new banks merely because the promoters are without experience in banking or have not established their

reputation as honourable men ; and I fear that as long as people will listen to mere promises of dividends, and will subscribe readily for shares in new banks without knowing anything about the management, the Government cannot afford such shareholders much protection.

In talking to bankers I shall therefore discuss bank failures only with regard to the liabilities to the public. In this respect, if you will examine the statement with accompanying comment at page 120 of the 1909 edition of my "History of Banking in "Canada," you will see that since the bank-notes have been made a prior lien (1880) on the assets of the bank, no failure has occurred in which the note issues have not been paid in full, while out of twenty banks which have been completely liquidated since Confederation, eleven, having liabilities of \$40,057,543, have paid all creditors in full, and nine, having liabilities of \$16,787,465, have paid dividends from $10\frac{6}{7}\%$ to $99\frac{2}{3}\%$ per cent., the total loss to noteholders and depositors amounting to about \$4,500,000. This means that in over forty years the loss to creditors has been a trifle over two-fifths of one per cent. of the present liabilities of the banks.

Bank Inspection.

We have in Canada no system under which the annual statements of banks are verified by independent auditors, nor have we, as in the United States, a system of Government bank examiners. At the revision of the Bank Act in 1890 we resisted the attempt to introduce either of these systems, because, in our opinion, they tended to produce in the public mind an assurance of safety which would certainly not be warranted by anything that external examination could accomplish. Recent failures, accompanied by false statements and other criminal acts, have caused a widespread demand for some kind of independent examination, and, as we are at the moment engaged in one of our decennial revisions of the Bank Act, the subject is one of unusual interest in Canada. Facts show that, in the main, those who need protection are the shareholders, and our common sense must tell us that, so long as banks fail, shareholders must lose, and that no inspection will prevent the making of bad loans, from which cause most failures arise. Audit has not prevented bad failures, and the record of Government inspection is worse. What, then, can we do?

When we undertook, as I have heretofore explained, to guarantee the note issue of every bank, we soon found that we needed the power to inspect the note-issue records of each bank and some protection at the moment of the suspension of a bank. As a result, the Canadian Bankers' Association, which had already

been in existence for about ten years, was regularly incorporated in 1900. Among other powers, it was entrusted with the appointment of a curator to supervise the affairs of any bank which might suspend payment, until the resumption of its business or the appointment of a liquidator; with the supervision of the bank-note issues, including the making, delivery and destruction of the notes and the inspection of the circulation accounts of the banks; and with the imposition of penalties for the breach or non-observance of any by-law, rule or regulation made by virtue of the section, all such by-laws, rules and regulations being subject to the approval of the Treasury Board.

For many years some members of the Canadian Bankers' Association have thought that there should be in the Association a committee of bankers possessing the respect of the bankers as a whole, having authority to confer with the authorities of any bank which seemed to be getting into bad courses. In this way the worst features of recent bank failures might have been averted, even if the actual failure of the bank could not. Two strong objections, however, have always been raised to the creation of such a committee: (1) The Association has no legal power to enforce its views upon any erring bank. (2) It is, undoubtedly, a very serious matter indeed for the Association to assume even the appearance of responsibility for the management of the banks as a whole. In spite of this, the conviction that no inspection would be of any real benefit to the public unless made under the auspices of the banks acting as a whole, caused the speaker to work out a proposal which, with the authority of the committee of members of the Association having the subject in charge, will be offered for consideration when the Act is discussed by the bankers with the Government. If the suggestions are accepted, the Government will impose upon the Canadian Bankers' Association, within well defined limits, the duty of bank inspection. The Association would, as a consequence, appoint a bank examiner or examiners, with assistants. Such examiners would periodically—say, not less often than every two years—visit the head office of every bank in Canada, and test the accuracy of its balance-sheet in a manner quite as complete as any audit. If the head-office department possessed any actual banking assets, such as bills, securities, real property, etc., these would be examined in the same manner as in an ordinary bank inspection, but, in the main, the balance-sheet would exhibit the relations between the head office and the branches, the bank premises, profit and loss, contingent and other accounts. Those accounts which could be verified on the spot in the usual way would be so verified. The vital point would, of course, be the branch accounts. For these the examiner would require the declaration of the routine and loan inspectors as to the last date of inspection

and as to the accuracy of all facts set forth in the branch balance-sheet at that time; a similar declaration from the chief inspector, coupled with the statement that, in his opinion, there had been made, at the time of the last statement to the shareholders, the necessary provision for all bad and doubtful debts; and also a similar declaration from the general manager. This is, frankly, only an inspection of the system of inspection of each bank, except as regards the head office, but that is practically all that audit does, and we shall make it clear that it does not pretend to do anything more.

If this was all we desired to effect, little would have been accomplished. The Association would also appoint a committee of leading bankers to whom the reports of the examiner would be made, and this committee would have power to direct the examiner to carry further than the mere head office inspection referred to, the investigation into the affairs of any bank regarding which suspicion had arisen. This latter power is, of course, the kernel of the matter. It would be a responsibility of the gravest kind. It may well be said that when such a committee orders as complete an examination of the affairs of a suspected bank as our own internal bank inspection, they must be very sure indeed that the scrutiny will justify their fears.

But between the examination which is no better than an audit and the complete examination referred to there are many stages, and it is safe to say that the mere demand by such a committee for returns regarding particular matters which have caused suspicion would have resulted in completely altering for the better the course of some banks which, because they were responsible to no authority, have gone easily down the road to failure. The proposal is full of detail, which I cannot enter upon here. It would not, of course, prevent occasional failures, but it would, I think, arrest them before they reached the disgraceful stages accompanying some recent cases.

I must not be regarded as favouring a system under which the Government tries to do difficult, if not impossible things in order to save the individual from the result of his own folly, but our people, as in many modern democracies, expect the State so to protect them, and those who manage corporations which possess valuable franchises from the State do at least sometimes desire that such efforts at State protection shall be practicable and not imaginary.

Bank Premises.

It may well be supposed that during this period of rapid expansion the question of bank premises has been difficult to control. The Canadian banker has, however, had in the leading

bank and some others, examples of determination to keep down that item in the balance-sheet.

The growth of bank premises as an asset has been as follows:—

Dec. 31st, 1867	...	...	...	...	\$1,603,865
Dec. 31st, 1870	...	...	...	...	1,684,497
Dec. 31st, 1880	...	...	...	...	3,140,523
Dec. 31st, 1890	...	...	...	...	4,187,572
Dec. 31st, 1900	...	...	...	...	6,496,104
Dec. 31st, 1905	...	...	...	...	11,569,131
Dec. 31st, 1910	...	...	...	...	25,191,619

From a recent statement in a financial journal* I learn that twenty-three banks have, from 1903 to 1910 inclusive, written off out of profits the sum of \$9,147,696. This does not include the Bank of Montreal, which has not given any information in its annual statements until last year, when the President stated that their bank premises, although entered upon their balance-sheet at \$600,000, are worth between seven and eight million dollars. I think it is commendable that during years of unusual profits the bankers should have applied their profits so largely in this manner and have resisted the temptation to further increase their dividends.

Bank Pensions.

Ten or fifteen years ago there were few banks who had begun the task of building up funds out of which to provide for retired officers and for widows and orphans of officers. From the same journal I learn that from 1900 to 1910 inclusive \$1,600,825 of bank profits were set aside for this purpose, in addition, of course, to payments by officers. And, while six banks laid aside \$72,630 in 1900, in 1910 seventeen banks laid aside \$279,598. These figures do not include the Bank of Montreal and two or three other banks who do not publish figures connected with their pension funds.

Allow me to close by apologizing on the one hand for the length of my paper and on the other for the many things I have failed to deal with concerning finance and banking in Canada.

* The "Chronicle," Montreal, 17th March, 1911.

